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# Hurly-Berle—Corporate Governance, Commercial Profits, and Democratic Deficits

*Allan C. Hutchinson*†

"The Berle-Means corporation . . . is an adaptation, not a necessity."
-Mark Roe[1]

The financial crisis over the last couple of years has exacted a heavy toll. Large corporations have gone to the wall, banks have needed to be bailed out, and whole national economies have collapsed. Amidst this mayhem, schemes of corporate governance have come under close scrutiny. Punishing inquiries have been made about their role and performance in contributing to or failing to avert the crisis. As allegations of greed, incompetence, and irresponsibility by corporate bigwigs have abounded, many have asked whether the structures and processes of corporate governance have been equal to their supposed task of shaping and controlling corporate activities. Indeed, the debate about the validity of the whole approach to corporate governance has become an organizational bellwether in efforts to diagnose and remedy the ills of the financial crisis.

In this Article, I want to make a distinctive contribution to that debate. On the basis that no crisis should be wasted, I propose that substantial and substantive changes are required in prevailing ways of thinking about and implementing corporate governance. Contrary to the views of many commentators, I maintain that it is the whole nature of what counts as "good corporate governance" that must be rethought and reconstructed from the conceptual ground up. In order to inform and accomplish this goal, I will move beyond the traditional evaluative focus of economic success and instead look to a more inclusive and democratic standard of social well-being. Drawing upon an expansive understanding of the role

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1. MARK J. ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE 287 (1994).

of corporations in modern society and its recent crises, I will suggest ways in which the performance of corporations can be appreciated and assessed in terms of both economic and social improvement. The Article is based upon and devoted to offering a re-visioning of Berle and Means's *The Modern Corporation and Private Property.*[2]

Although Berle and Means's work was intended to redirect the governance of corporate affairs away from furthering private cupidity and toward advancing public policy, their insights have done more harm than good; they have tended to reinforce the primacy of private cupidity or, perhaps more accurately, allowed subsequent theorists to prefer the pursuit of private cupidity by equating it with the development of public policy. This is not only unfortunate, but also unnecessary. Although Berle and Means's *The Modern Corporation* forms the bedrock of the prevailing paradigm in corporate law and governance, it also contains some very suggestive materials from which to construct an alternative and more democratic way of proceeding that actually subverts and transforms the established model. The remaining bulk of this Article seeks both to celebrate *The Modern Corporation*, but also to lament the enduring influence of its received understanding on corporate law scholarship and practice. If *The Modern Corporation* is to avoid becoming "defunct" and remain relevant to contemporary ideas and practice, it must be more as a conceptual corrective and less as a traditional prop for the prevailing paradigm of corporate governance.

The Article is divided into seven Parts. Part I discusses the role played by corporate governance during the current crises and why such governance fails to address the underlying causes. Part II sets out the context and general thrust of Berle and Means's *The Modern Corporation* in 1932. Part III looks to the shifts in corporate history since 1932, and Part IV explores the basic inadequacy of the traditional Berle and Means paradigm of corporate governance. After offering a different and more democratic inspired reading of *The Modern Corporation* in Part V, there is an examination in Part VI of how it might be feasible to move from the present situation of corpocracy to a future milieu of democracy. Finally, Part VII lays out the main features of a democratic agenda for reforming corporate governance. Throughout the Article, the emphasis is on capturing the suggestive possibilities of a democratic approach rather than laying down a dogmatic program for changes in corporate governance models.

2. ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (Harcourt, Brace & World rev. ed., 1968) (1932).

## I. CRISIS AND GOVERNANCE

Somewhat surprisingly, there seems to be a general level of consensus about the primary causes of the present crisis. Although considerable disagreement exists about the important details of their precise dynamics and relative weighting, it is agreed that "short-termism" and "executive self-interest" played crucial and complementary roles in fueling the excessive risk-taking that was at the heart of the financial crisis.[3]

First, management and boards became increasingly focused and, in some cases, fixated on inflating or maintaining a company's share price in the short term without genuine or great concern for the long-term well-being of the company. Operating without sufficient capital backing and relying on precarious lending, companies leveraged their limited assets without adequate regard for (il)liquidity constraints. All this was compounded by the hands-off monetary policies and lax regulatory practices of governments. This was most apparent and devastating in the mortgage market, which—ballooned up by a toxic mix of imprudent initiatives, junk financing, predatory marketing, and regulatory indifference—exploded to devastating effect.

Second (and in combination with short-termism), the executive officers of corporations authorized and pursued enormously risky business projects in order to reap substantial profits, ramp up the company's short-term share price, and earn large bonuses and enhanced compensation for themselves. Although efforts to tie executive compensation to their companies' economic performance were originally intended to act as both an incentive and disciplinary device for management, it came to be revealed as a dangerous development that encouraged executives to take very risky gambles that had short-term benefits but exposed companies to substantial mid- to long-term costs.[4] A smash-and-grab mentality began to take hold; the underlying fundamentals of the corporate condition were given short shrift. As the crisis vividly demonstrated, the apparently healthy state of the general economy and stock market in the first few years of the new century was revealed to be more the deceptive boom before the inevitable bust than anything else.

The primary concern of this Article is not with the causes of the crisis, but with the role that corporate governance played: Did corporate governance fail? And, if so, what can be done about it? Predictably, there is considerable disagreement. Some are not even persuaded that the fi-

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3. *See* RICHARD A. POSNER, A FAILURE OF CAPITALISM: THE CRISIS OF '08 AND THE DESCENT INTO DEPRESSION 75–116 (2009) (discussing the underlying causes of the 2008 financial crisis). The fact that this book is by a former "capitalist promoter" only adds to the book's power and poignancy.

4. *See, e.g.*, LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION (2004).

nancial crisis can be attributed at all to the prevailing schemes and approaches to corporate governance. For instance, Brian Cheffins insists that corporate governance functioned "tolerably well" in the largest American companies.[5] In a survey of Standard & Poor's top 500 companies, he claims to demonstrate that, in the thirty-seven companies removed from Standard & Poor's list, their schemes of corporate governance operated satisfactorily. Moreover, he contends that over 70% of the fifteen companies with the worst-performing stocks in 2008 did not have staggered boards, did not have a poison pill in place, and had majority voting or a director resignation policy. As such, Cheffins concludes that "the case in favor of dramatic reform [of current corporate governance arrangements] has yet to be made out."[6] He is still willing to place his faith in the lightly regulated disciplinary play of market forces.

Although Cheffins's survey and analysis are indeed cautionary, the conclusions that he draws are overstated and unreliable. He confirms the old adage that "if you ask the wrong question, then you will get the wrong answer." Leaving aside the fact that market forces did more to facilitate the crisis than prevent it, there is simply too much taken for granted in his approach: the enabling role of the blinkered and overriding directorial fiduciary duty to enhance shareholder value is one villain of the legal piece. Asking if corporate governance was the, or even a "cause" of the crisis is plain silly. It is similar to asking if the lack of a safety device was the cause of an accident. A much more sensible inquiry is whether corporate governance, like a safety device, might have inhibited certain kinds of risky behavior or contained the calamitous effects of certain eventualities. Looked at in this light, it recommends a more attentive scrutiny of corporate governance's capacity to check and channel the kind of short-term and excessive risk-taking that precipitated the crisis.[7]

The more general response to these crisis-contributing features of contemporary corporate culture has been more positive and encouraging. Acknowledging that there has been "a widespread failure of corporate governance," the U.S. Senate proposed a Shareholder Bill of Rights Act, which introduces measures to boost the long-term health and stability of firms and their shareholders.[8] These include more transparent compensation practices, greater executive accountability, and enhanced risk man-

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5. Brian R. Cheffins, *Did Corporate Governance "Fail" During the 2008 Stock Market Meltdown? The Case of the S&P 500*, 65 BUS. LAW. 1, 50 (2009).

6. *Id.* at 51.

7. *See Corporate Governance in Financial Institutions and Remuneration Policies*, EUROPEAN COMM'N (June 2, 2010), http://ec.europa.eu/internal_market/company/docs/modern/com2010_284_en.pdf.

8. Shareholder Bill of Rights, S. 1074, 111th Cong. (2009).

agement. This has been supplemented by further legislative initiatives, which introduce tighter control over executive compensation by way of claw backs and greater shareholder say-on-pay, and which mandates improved adviser independence and majority voting for directors.[9] Of course, the impact of these measures will depend on the willingness of Congress and the Administration to enforce such requirements in a robust and consistent manner.

These legislative measures are nothing to be sniffed at. Most of these reforms might well have a salutary effect on the attitudes and actions of corporate directors and executives. But they do not do nearly enough to address some of the deeper and continuing sources of corporate misgovernance. They still manage to operate and acquire validity within the traditional paradigm of corporate governance. Rather than simply place checks and balances on existing boards or transfer increased power to shareholders, a more root-and-branch restructuring of the dynamics and structures of corporate governance is needed. The size and consequences of the crisis demand a series of changes that are of the same extent and impact. If there is to be any real progress in averting future crises and putting corporate activity on a truly more stable footing, it will be necessary to go beyond the structural tinkering that characterizes present reform efforts.

For example, a 2009 study by David Erkens, Mingyi Hung, and Pedro Matos points to the inadequacy of measures to make boards more accountable to shareholders and to increase the independence of boards.[10] Examining the performance of 296 financial firms from 30 countries that were at the center of the financial crisis, the authors reveal that firms with more independent boards and higher institutional ownership experienced worse stock returns during the crisis period.[11] They go on to suggest that the reasons for this result are twofold—because firms with higher institutional ownership took more risk prior to the crisis, which resulted in larger shareholder losses during the crisis period; and because firms with more independent boards raised more equity capital during the crisis, which led to a wealth transfer from existing shareholders to debt-holders.[12] By way of conclusion, they cast doubt on whether regulatory changes that increase shareholder activism and improve moni-

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9. *See, e.g.*, Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, 124 Stat. 1376–2223 (2009).

10. David Erkens, Mingyi Hung & Pedro Matos, FED. DEPOSIT INS. CORP., *Corporate Governance in the 2007–2008 Financial Crisis: Evidence from Financial Institutions Worldwide* 20–21 (Aug. 2009), http://www.fdic.gov/bank/analytical/CFR/bank_research_conference/annual_9th/Matos_P.pdf.

11. *Id.* at 2.

12. *Id.* at 20.

toring by outside directors will be effective enough in reducing the consequences of future economic crises.[13]

Accordingly, I maintain that the recent crisis has underscored the urgency of attending to the theoretical foundations of present and future practice. This is not only because of the scandals and calamities that have occurred, but also because of the enacted reform's relative failure to address the deeper sources of the crisis that face corporate governance: the diagnosed condition and the reputed cure are part of the same informing paradigm.[14] Although theoretical posturing is considered indulgent by the tough-minded sensibilities of the corporate community (including, often, corporate law scholars), the current practice of corporate governance is in thrall to a very partial cluster of conceptual premises: "Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist."[15] The path-breaking work of Berle and Means lies at the heart of this project: it is both part of the problem and part of the solution.

## II. 1932 AND ALL THAT

The seventy-fifth anniversary of the 1932 publication of Adolf A. Berle and Gardiner C. Means's *The Modern Corporation and Private Property* passed without too much notice. This classic work is universally acknowledged as one of law's undisputed canonical texts. While it has aptly been described as "arguably the most influential book in U.S. business history,"[16] its importance is not merely as a historical curiosity; it has remained a mainstay of corporate law and scholarship up to the present day. While the book's detailed analysis of corporate governance and the particulars of its reform proposals have become less important over time, it still exerts extensive conceptual influence. The fact that the book is no longer referenced as frequently is less an indication of its

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13. *Id.* at 21.

14. Some commentators, of course, maintain that those reforms went too far. *See, e.g.*, Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1529 (2005).

15. JOHN MAYNARD KEYNES, THE GENERAL THEORY OF EMPLOYMENT, INTEREST, AND MONEY 383 (1936). He went on to conclude that "[m]admen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back. I am sure that the power of vested interests is vastly exaggerated compared with the gradual encroachment of ideas. . . . Soon or late, it is ideas, not vested interests, which are dangerous for good or evil." *Id.* at 383–84.

16. Peter F. Drucker, *Reckoning with the Pension Fund Revolution*, 69 HARV. BUS. REV. 106, 114 (1991). In a similar vein, it has been said that "[n]o field of American law has ever been so totally dominated by one work as the corporation law area has been by the Berle and Means classic." Henry G. Manne, *Intellectual Styles and the Evolution of American Corporate Law*, *in* ECONOMIC IMPERIALISM: THE ECONOMIC APPROACH APPLIED OUTSIDE THE FIELD OF ECONOMICS 219, 223 (Gerard Radnitzky & Peter Bernholz eds., 1987).

dated quality and more a testament to its foundational status. Indeed, it would be no exaggeration to report that, as befits a book of its stature, *The Modern Corporation* continues to provide the general intellectual framework within which much traditional thinking about corporate governance in both law and business takes place. This is as true for the status quo's defenders as well as its detractors. Therefore, any serious effort to appreciate, let alone transform, the theory and practice of contemporary corporate governance must pay close and critical attention to *The Modern Corporation*.

Although Berle and Means's work had a prescient quality to it, *The Modern Corporation* was very much a product of the 1920s. The first quarter of the twentieth century had witnessed a massive and rapid surge in America's capital economy. Along with this rise in economic development and prosperity, there was a shift in production from small businesses to huge conglomerates; the accumulation of vast fortunes and the concentration of corporate power in elite hands were hallmarks of the period. Culminating in the stock market crash of 1929 and the Great Depression, this era of unfettered capitalism was beginning to collapse under its own burgeoning weight. By the late 1920s, the juggernaut of corporate organization was being more closely scrutinized and its pervasive influence challenged. In what began as a research project for the Social Science Research Council of America, Columbia law professor Adolf A. Berle, Jr. sought out an economist with a statistical bent to work with to produce a more empirical and technical understanding of corporate development; he was paired up with Gardiner C. Means. Their unusual collaboration sought to appreciate the corporation as a social institution as well as an economic organization. This huge undertaking was projected to be "the work of a lifetime," and *The Modern Corporation* was to be the opening volume "intended primarily to break ground on the relation which corporations bear to property."[17] As such, it was meant to be the first and not the last word on the corporation as a human institution.

Means's extensive mapping of the contemporary corporate terrain was novel and revealing. In an examination of the 200 largest nonfinancial corporations in 1929, he found that in only 11% of the firms did the largest owner hold a majority of the firm's shares. Further, establishing ownership of 20% of the stock as a threshold minimum for control, it was discovered that 44% of those firms had no individual who owned that much of the stock. These 88 firms, which were classified as man-

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17. BERLE & MEANS, *supra* note 2, at xli. For two very different approaches to the history of the modern corporation, see JOHN MICKLETHWAIT & ADRIAN WOOLDRIDGE, THE COMPANY: A SHORT HISTORY OF A REVOLUTIONARY IDEA (2003) and JOEL BAKAN, THE CORPORATION: THE PATHOLOGICAL PURSUIT OF PROFIT AND POWER (2004).

agement controlled, also accounted for 58% of the total assets held among the top 200 corporations. As analyzed by both Berle and Means, the upshot of these statistical insights was that there were two significant and pressing features to be addressed—the growing concentration of power within a relatively small number of large corporations and the increasing dispersal of stock ownership resulting in a widening gulf between share ownership and executive control within those corporations. While each trend was important in itself, their combination persuaded Berle and Means that a corporate revolution had occurred and that a new frame of reference was required to appreciate it fully and deal with its legal and social ramifications. Although the fact of growing corporate power provided the informing backdrop, however, the major thrust of their report was the struggle to come to terms with the separation of ownership and control. Indeed, this characterization of the challenge became "the master problem for research" in corporate law.[18] The growing concentration of corporate power was more a contextual concern than a central problem, presumably to be explored more fully and directly in a later, but never realized, volume.

In examining the organizational implications of the historical shift from family-owned firms to large, widely held corporations in which there was separation of ownership and control, Berle and Means continued, as they refined, a traditional view on corporate governance. They insisted quite straightforwardly that corporations ought to be run by the management whose powers were to be held in trust for stockholders as the sole beneficiaries of the corporate enterprise. As the separation between share ownership and managerial control was becoming increasingly wide, they worried about "the concentration of economic power" creating "empires" that permit "a new form of absolutism" to be exercised by "the new princes" and "economic autocrats" of controlling management.[19] In an arresting phrase, they noted, "A Machiavelli writing today would have very little interest in princes, and every interest in the Standard Oil Company of Indiana."[20] Indeed, they were so concerned about the power of management that they compare the board of directors to "a communist committee of commissars" and cast the director as someone who "more nearly resembles the communist in mode of thought than he does the protagonist of private property."[21] In combating such

18. Roberta Romano, *Metapolitics and Corporate Law Reform*, 36 STAN. L. REV. 923, 923 (1984).

19. BERLE & MEANS, *supra* note 2, at 116.

20. Adolf A. Berle, Jr. & Gardiner C. Means, *Corporations and the Public Investor*, 20 AM. ECON. REV. 54, 71 (1930). For an excellent biographical account, see JORDAN A. SCHWARZ, LIBERAL: ADOLF A. BERLE AND THE VISION OF AN AMERICAN ERA (1987).

21. BERLE & MEANS, *supra* note 2, at 245.

disturbing consequences of the shift in corporate holdings, Berle and Means maintained that the primary role of corporate law was to ensure that "all powers granted to a corporation or to the management of a corporation, or to any group within the corporation, . . . are necessarily and at all times exercisable only for the ratable benefit of all the shareholders."[22] Because it is the liquidity of their property that most concerns shareholders, not their involvement in the corporation's management, corporate law could rightly arrogate to itself the task of acting as general overseers of management and subscribe to the commitment that "a corporation should be run for the benefit of its owners, the stockholders."[23]

For Berle and Means, therefore, the task was to work out how best to shape corporate law so that it could respond effectively and efficiently to the intricate and operational consequences of the divide between diffuse owners and self-serving managers. Put more bluntly, their main focus was on ensuring that managers do not ignore the absentee owners and line their own pockets at the expense of the shareholders. Although retaining a continuing, if partial, faith in the market to discipline management and to protect shareholders' expectations, they pinned their reform hopes on judicial intervention to discipline managers in the name of shareholder confidence. With varying degrees of success, this was to be achieved by mandating the primacy of shareholder voting in all-important corporate decisions and the imposition of fiduciary duties on management (i.e., demanding that managers place the corporation's interests ahead of their own). In effect, they gambled on the willingness and suitability of courts to fashion and police a series of strict and equitable obligations such that "corporation law becomes in substance a branch of the law of trusts."[24]

The main legacy of *The Modern Corporation*, however, is Berle and Means's framing of the ownership/control problem as the central dynamic of corporate law and organization. This remains the fundamental and taken-for-granted framework within which contemporary thinking occurs. But, notwithstanding the almost universal acceptance in the ensuing seventy-five years of the accuracy of their diagnosis of the ills that afflict corporate governance, their descriptive observations have not been matched by that of their prescriptive recommendations. While their reform proposals have seen some measure of success, they have not carried the day; they are something of "a policy relic."[25] Incorporation of

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22. *Id.* at 220.
23. *Id.* at 293.
24. *Id.* at 242.
25. William W. Bratton, *Berle and Means Reconsidered at the Century's Turn*, 26 J. CORP. L. 737, 739 (2001). Berle and Means's concerns about the owner–manager divide were echoed by

Berle and Means's reform proposals into corporate law has been half-hearted at best, and their capacity to restrain corporate malfeasance has clearly been lacking in practical effect. More recently, commentators have turned to the market by way of possible takeovers and performance-based compensation as further modes of discipline such that inefficient managers would be replaced by profit-seeking shareholders.

In large part, Berle and Means's reform proposals relatively failed because they could not or would not move beyond the "private property" logic of the traditional paradigm; profit maximization and the protection of shareholders' ownership entitlements were still the order of the day. Their support for governmental and judicial intervention was premised on the limitation that these official agencies would act as public surrogates for private shareholders' control. In anointing managers as the "princes of industry"[26] and recommending that they must serve the community as a whole by ordering their affairs "on the basis of public policy rather than private cupidity,"[27] there was the distinct whiff of *noblesse oblige* around even relatively liberal boardrooms in matters of corporate governance. Indeed, with their commitment to the idea that shareholders are "the owners of the corporation," Berle and Means offer a lament for the lost "active" shareholder who is left with "a mere symbol of ownership."[28] After all, the full title of their book is *The Modern Corporation and Private Property*. For them, a private property regime provides the best incentive to ensure that property is used efficiently in the sense that "the quest for profits will spur the owner of industrial property to its effective use."[29] Accordingly, the central thrust of Berle and Means's reform proposals was to close the gap between owners and management as much as the legal imposition of equitable duties can do so as to emulate or approximate the ideal situation of owner-managers. Theirs was less of a break with the tradition of "shareholder primacy"

critics of the democratic process's operation more generally. *See generally* JOSEPH A. SCHUMPETER, CAPITALISM, SOCIALISM, AND DEMOCRACY (1942); Seymour Martin Lipset, *Introduction*, *in* ROBERT MICHELS, POLITICAL PARTIES 15–39 (1962). Not all commentators saw the disjuncture as problematic, instead viewing the greater dispersal of capital as a harbinger of "people's capitalism" and greater democracy. *See* Carl Kaysen, *The Social Significance of the Modern Corporation*, 47 AM. ECON. REV. 311 (1957). *See generally* Mark S. Mizruchi, *Berle and Means Revisited: the Governance and Power of Large U.S. Corporations*, 33 THEORY & SOC'Y 579 (2004). For a very different account of corporate history and politics, see Dalia Tsuk, *Corporations Without Labor: The Politics of Progressive Corporate Law*, 151 U. PA. L. REV. 1861 (2003). She notes that "by focusing on entrepreneurs and investors, they helped legitimize a conception of value or wealth that was detached from work and labor." *Id.* at 1868.

26. BERLE & MEANS, *supra* note 2, at 4.

27. *Id.* at 313.

28. *Id.* at 65.

29. *Id.* at 9.

and more of a continuance of it. There may well have been a "corporate revolution" by 1932, but Berle and Means were far from revolutionary in their response.

## III. CHRONICLE OF AN END FORETOLD

Much has changed since 1932 in the world of capitalist economies and corporate organization. If the forces of "concentration" and "separation" were in play in Berle and Means's day, they have been supplemented by others—institutional investors, takeovers and mergers, financial entrepreneurship, and the like—and become even more powerful and relentless today. Yet, if Henry Hansmann and Reinier Kraakman were to be believed, the first few years of the twentieth century witnessed "the end of corporate history." Echoing the apocalyptic pronouncements of Francis Fukuyama from a decade earlier, they declaimed in 2001 that "the basic law of corporate governance—indeed, most of corporate law—has achieved a high degree of . . . continuing convergence toward a single, standard model . . . [and t]here is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value."[30]

But how wrong they were! The crisis of 2008 turned over a fresh page in corporate history. It revealed that the "end of history" thesis was little more than wishful thinking by Hansmann and Kraakman. Their reasoned analysis was leavened by ideological advocacy. At best, it can be reported that the mainstream of corporate lawyers and commentators have settled on "shareholder primacy" as the preferred normative goal. This is less because it has achieved an objective and universal status, but more because few are prepared or have sufficient incentive to resist the economic and political clout of those championing its contemporary hegemony. It may well be a descriptive fact that "governance practice is

30. Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 439 (2001). No mention is made of Francis Fukuyama who (in)famously argued that the world had beaten a path to American liberal democracy on the unfolding carpet of a Universal History whose woof and warp comprise the motifs of political individualism and economic privatism. While it is incompletely implemented and capable of further refinement, the ideal of liberal democracy marks the final end of history: "[T]he modern liberal democratic world . . . is free of contradictions" and "[a]t the end of history, there are no serious ideological competitors left to liberal democracy." FRANCIS FUKUYAMA, THE END OF HISTORY AND THE LAST MAN 139, 211 (1992). For a powerful critique of this viewpoint, see JACQUES DERRIDA, SPECTERS OF MARX: THE STATE OF THE DEBT, THE WORK OF MOURNING, AND THE NEW INTERNATIONAL 56, 69, 78 (Peggy Kamuf trans., 1994) (1993). Even Fukuyama himself has had serious second thoughts about his original "end of history" thesis. *See* FRANCIS FUKUYAMA, AMERICA AT THE CROSSROADS: DEMOCRACY, POWER, AND THE NEOCONSERVATIVE LEGACY, at xi (2006).

largely a matter of private ordering,"[31] but that does not mean that it should be accepted as a prescriptive recommendation. Yet, even in the few years since 2001, events in the corporate world have not only confounded Hansmann and Kraakman's optimism, but also have highlighted how fragile and defective the reliance on shareholder primacy has become.

Despite these end-of-history prognostications, the fact remains that Berle and Means's account of the problem to be solved still informs most corporate law thinking. Almost all scholars and commentators are still in the grip of a traditional mind-set in which the interests of shareholders are paramount; shareholder primacy remains the guiding light of corporate law and scholarship. What has changed over the past seventy-five years, however, is that there have been varied and umpteen efforts to explain and rationalize this informing mandate so that it can have the largest possible claim to normative legitimacy. Along with a continuing reliance on the "private property" rationale, there are three other dominant arguments relied on by contemporary theorists to explain and support the continued reliance on shareholder primacy as the preferred rationale for corporate law and governance; they are "market discipline," "social wealth," and "shareholder democracy." Each of these arguments is deeply flawed and unconvincing; there has been much heat, but little light.

### *A. Property Ownership*

The defense of shareholder primacy that runs most directly from Berle and Means's ideas is the claim that those who own the corporation are entitled to have the corporation operate in their interests and receive any resulting profits. While this defense still has its supporters, it has lost much of its argumentative appeal.[32] The private property rationale mis-

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31. Hansmann & Kraakman, *supra* note 30, at 455. For a more interesting spin on the "historical progress" of corporate law scholarship, see Brian R. Cheffins, *The Trajectory of (Corporate Law) Scholarship*, 63 CAMBRIDGE L.J. 456 (2004). While there are strong pressures toward convergence, the history and political economy of comparative corporate governance strongly suggests that there is no particular magic to any particular mode of corporate organization and structure. Advanced economies have managed to develop and grow by reliance on a variety of systems of corporate governance; there is no one size that fits all or, as importantly, no one size that necessarily fits best. *See* Ronald Dore et al., *Varieties of Capitalism in The Twentieth Century*, 15 OXFORD REV. ECON. POL'Y 102 (1999).

32. *See* Thomas Gale Moore, *Introduction* to *Corporations and Private Property: A Conference Sponsored by the Hoover Institution*, 26 J. L. & ECON. 235 (1983). For a sampling of the theorists who champion "shareholder primacy," see William T. Allen et al., *The Great Takeover Debate: A Meditation on Bridging the Conceptual Divide*, 69 U. CHI. L. REV. 1067, 1075 (2002); Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423 (1993); Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005); Jonathan R. Macey, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary*

construes both the particular import of owning shares in a corporation and the general consequences of property ownership. While there can be little doubt that shareholders have property rights over shares, which can traditionally be treated as ownership, it does not mean that they, therefore, have similar ownership rights over the corporation. For instance, the fact that I buy a lottery ticket does not mean that I own part of the lottery corporation. While I do own the lottery ticket and have certain traditional property rights (e.g., to destroy it or give it to someone else), it does not mean that my relation to the lottery corporation is one of owner. While shareholders have various rights of "ownership" (e.g., to sell stock, vote proxies, sue directors, receive certain information, get residual payouts from a corporation's liquidation), it is not convincing to assert that shareholders own the corporation in the same way that people own their cars or houses. Moreover, even if it is conceded that shareholders are to be treated as "the owners of the corporation," it by no means follows that they are entitled by virtue of that status to have the corporation run entirely in their sole interests. Whatever property ownership was originally considered to entail, the claims of property owners are no longer envisaged or enforced as if they were unreserved and trumped all other competing claims and interests. The rights of property owners are fundamental, but not absolute.[33]

The private property argument tends to beg the very question that it is intended to answer. In a democracy, private property has its important place, but it is not the foundational source of all other rights and no longer, if it ever was, the right against which all other claims are to be measured. Even when it comes to owning real property (e.g., a house or land) or personal property (e.g., cars or books), there is no entitlement that the owners' interests and desires will always be given precedence over others' interests; there are a whole host of codes, regulations, rules, and conventions that curtail the freedom and entitlements of owners. Indeed, corporate law itself is chock-full of examples that contradict the stark idea that shareholders "own" the corporation—shareholders can be restricted as to whom they sell their shares, how they vote for management, when they must offer to buy others' shares, etc. Furthermore, in an economy of relatively diffuse shareholding, many shareholders are decidedly

*Duties*, 21 STETSON L. REV. 23 (1991); and Mark Roe, *The Shareholder Wealth Maximization Norm and Industrial Organization*, U. PA. L. REV. 2063 (2001).

33. *See* SAMUEL BOWLES & HERBERT GINTIS, DEMOCRACY AND CAPITALISM: PROPERTY, COMMUNITY, AND THE CONTRADICTIONS OF MODERN SOCIAL THOUGHT, at xi (1986). It is entirely puzzling why "the rights of ownership prevail over the rights of democratic citizenry in determining who is to manage the affairs of a business enterprise whose policies might directly affect as many as half a million employees, and whose choice of product, location, and technology touches entire communities and beyond." *Id.*

passive by preference and have no interest in being involved in the management of the corporations in which they invest; the self-image of the average investor is not one of corporate owner. Accordingly, as in almost all other areas of law, corporate shareholding does not comprise a black-and-white set of fixed entitlements, but is a very colorful, highly shaded, and dynamic process. It is now accepted that property ownership is a matter of social calculation in which individual interests are measured with and against other people's interests.[34] As the state creates and gives legal identity to corporations, it is for the state or the public to determine who gets ownership over it and what that ownership entails. As such, the ownership of a share will not convey any necessary rights on its owner nor will it necessarily amount to ownership of the corporation from which the shares arise. As with all property ownership, shareholding will consist of a bundle of rights whose content and extent will not be a natural given, but will vary over time and across contexts.

### *B. Market Discipline*

The most sweeping defense of shareholder primacy comes from economics-inspired scholars. The world of corporate governance is considered to be an informal institutional venue for self-interested and motivated entrepreneurs to enter a series of consensual deals to advance their own private economic interests. Although the market is far from being ideal or even optimal in its operations, it is touted as the preferred or least-worst alternative through which to coordinate productive endeavors and meet the mixed needs of its participants. From such a standpoint, the public regulation of corporate governance is considered to be merely facilitative rather than directive. Corporate actors are to be left to exercise their private discretion in determining what is best for particular corporations and, by virtue of that, the public interest: the market will fill the gaps and exact a penalty on the deviant few who engage in dubious activities and unreasonable practices.[35] This competitive market behavior is supposed to solve the separation of ownership and control by a variety of disciplinary devices—minimizing agency costs (i.e., keeping managers in line with shareholder interests), containing the ever-present threat of takeovers, responding to competition among firms for successful managers, monitoring share prices in the stock market, etc. Corporate law clear-

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34. Jeremy Waldron, *Property Law*, *in* A COMPANION TO PHILOSOPHY OF LAW AND LEGAL THEORY 3, 7 (Dennis Patterson ed., 1999).

35. *See* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 31–34 (1991). The "nexus of contracts" idea is attributable to Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

ly favors the interests of shareholders over others because shareholders are more vulnerable as they are less able to find alternative outlets in the market for their services. They risk all their equity in the corporation's ventures and therefore are entitled to greater protection by being beneficiaries of the directors' fiduciary duty over the fate of the corporation.

The confidence placed in the capacity of market forces to fulfill these onerous responsibilities, however, seems extravagant and entirely suspect. The "great tragedy" of economics, like so many other academic disciplines, is that it is one more beautiful theory brought to its knees by ugly facts—it is reductionist in its insistence in viewing all social conduct in terms of market behavior; it manages, by giving everything a monetary value, to overvalue and undervalue much of human interaction; its leading concepts (voluntariness, transaction costs, etc.) are theoretically vague and practically indeterminate; it is ethically bankrupt in that it takes all personal preferences at face value and refuses to distinguish among them; it is self-serving in that it treats all personal preferences as independent of the social or market system in which they are generated and satisfied; it ignores the distinction between willingness to pay and ability to pay; and it celebrates individual autonomy over communal attachment.[36]

Any plausibility that the market can operate as a disciplinary technique through which to advance the larger public good is confounded by the sheer size and influence of today's corporations. These massive institutions begin to serve their own interests at the expense of everyone else's and distort rather than personify the entrepreneurial spirit of a market economy. Even Berle and Means accepted this, although they were not prepared to act fully upon it.[37] Accordingly, although many scholars preach the gospel of free markets, the cruel irony is that corporations are one of the greatest threats to the operation of free markets: competition is attenuated and limited to a few large players. As such, corporations have become super-citizens with enormous powers and influence that rival those of the state and the latter-day church, but with much less popular legitimacy and social accountability. Rather than be the justificatory underwriter of corporate institutions and enterprise, the validating operation of today's market is effectively hobbled by the continuing involvement of today's mega-corporations.

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36. *See* Robert Ashford, *The Socio-Economic Foundation of Corporate Law and Corporate Social Responsibility*, 76 TUL. L. REV. 1187, 1198 (2002).

37. *See infra* text accompanying notes 62–67.

### *C. Social Benefit*

A third justification for shareholder primacy is that it is the best way to ensure that corporate operations and profits work to the benefit of everyone in society: it is an "on a rising tide, all boats will rise" defense. Although it might appear paradoxical, it is argued that, even though interests of shareholders deserve no greater weight in this social calculus than do the interests of any other members of society, there is "as a consequence of both logic and experience, . . . convergence on a consensus that the best means to this end . . . is to make corporate managers strongly accountable to shareholder interests and, at least in direct terms, only to those interests."[38] In short, it is contended that the more wealth generated in a society, the better off or more satisfied the whole of society will be. By holding corporate powers in trust for shareholders, it will be the same as holding corporate powers in trust for the entire community: any efforts (and this is proportionately true for the efforts of corporations) that contribute to the increased wealth of a society are to be applauded. In short, maximizing profits and increasing share prices will not only benefit everyone, but also corporate profit-making and social service, far from being at odds with each other, can be understood as mutually reinforcing aspects of the same enterprise.

Despite its ingenious nature, this "rising tide" defense of the desirability of prioritizing the pursuit of corporate profits in the social scheme of things is as unconvincing on second look as it is on first glance: it is unsupported by "logic" and no evidence of "experience" is offered. There is surely no reason to accept at face value that, if a corporation declares profits of $1 million, social wealth is increased whether that profit is all distributed to one person, shared among the shareholders at large, spread among the various stakeholders, or distributed evenly across society. Economic growth will not in itself ensure that a society's economic health, let alone its broader democratic or social health, is rude or improving. Indeed, many small boats are sinking or capsizing in this economic flow; their ability to stay afloat, let alone make progress, might well be in real danger. Accordingly, while a society's overall economic growth is important and telling, it is not the sole or most important indicator of a society's general condition and improvement. That being the case, there is no self-evident reason to accept that an increase in its GDP is, without more, a consistent or convincing indication that a society is better off.[39] Indeed, an increasing GDP may actually exacerbate social

38. Hansmann & Kraakman, *supra* note 30, at 441.

39. BRANKO MILANOVIC, WORLDS APART: MEASURING INTERNATIONAL AND GLOBAL INEQUALITY 116–19 (2005). For instance, the financial wealth of the top 1% of U.S. households

divisions. While an increase might be better than a decrease, the circumstances of the increase or decrease and the distribution of those gains or losses will need to be measured against a broader and less exclusively economic standard. If some smaller or less sturdy boats sink before the increasing tide, then that is the price of progress. But this response seems crass, at best, because it is difficult to take satisfaction in society's overall increased wealth if there are still people who live in relative poverty and destitution.

### *D. Shareholder Democracy*

The final rationale for shareholder primacy is that it actually facilitates the achievement of democratic control over corporate activities and governance. The basic assertion is that, whatever the historical record suggests, the present distribution of shareholding is so diffuse and extensive that large corporations are actually controlled by society at large. After all, more Americans own stock today than ever before, and the United States has one of the most widely held corporate economies in the world with only about 20% of corporations owned or controlled by a single shareholder.[40] This developing trend is reinforced by the increasing role of institutional shareholders, like mutual funds and pension funds, which enable ordinary investors to participate in corporate affairs and exert their aggregated influence in a more effective manner. Indeed, some commentators have gone so far as to suggest that plutocratic rule is at an end and that the age of "pension fund socialism" is now upon us.[41]

But while these claims have some statistical credibility, their deeper significance is exaggerated. Although more Americans hold more stocks than ever before, their distribution is heavily skewed—the bottom three-quarters of households own less than 15% of all stock, barely one-third hold more than $5,000 in stock, and almost a half own no stock at all.[42]

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exceeds the combined wealth of the bottom 95%. *See* JEFF GATES, DEMOCRACY AT RISK: RESCUING MAIN STREET FROM WALL STREET, at xxxvii (2000).

40. *See* Rafael La Porta et al., *Corporate Ownership Around the World*, 54 J. FIN. 471, 492 (1999).

41. PETER F. DRUCKER, THE UNSEEN REVOLUTION: HOW PENSION FUND SOCIALISM CAME TO AMERICA 205 (1976). Of course, this turn of events is not greeted with glee by all. The major rationale for an increased and active voice by institutional investors is that it will "increase corporate efficiency and value." Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811, 887 (1992).

42. David Callahan, *The Myth of the Populist Stock Market*, CHRISTIAN SCI. MONITOR, Jan. 8, 2004, http://www.csmonitor.com/2004/0108/p09s01-coop.html. Most Americans have more debt on their credit cards than money in their mutual funds. *Id.* Between 1989 and 1997, 86% of stock market gains went to just the top 10% of households. *Id.* These figures reflect the deeper inequality that pervades American society. In 2002, the U.S. Gini coefficient (a measure of relative income inequality) was estimated to be 0.394. Thus, income inequality in the United States is higher than in France

This is very soft ground on which to support the claim that "shareholder democracy" is alive and well. Not only does the unequal distribution of share ownership fatally impair such claims, but the fact that most of these investors remain passive also does little to bolster them. Indeed, the incidence of institutional investment has actually exacerbated the divide between ownership and control. Even greater power is concentrated in a small cadre of investing professionals who have enormous control over the market and seem intent on exercising it to align themselves closer to management so as to obtain further business and advance their own interests. For instance, a recent study reveals that mutual funds have a definite tendency to back executive pay proposals and to oppose shareholder attempts to rein in such excesses: mutual funds support executive plans over shareholder opposition in almost three out of four instances.[43] Accordingly, while ensuring a more robust check on corporate management's self-serving tendencies is important, it does not address the broader concerns of corporate governance in a democratic society. Not surprisingly, the advancement of private interests has been the primary goal of institutional investors; the public interest has taken a distinct second place or has been reduced to much the same as the aggregate maximization of private interest. There is, at best, a faux democracy at work in contemporary corporate governance.

## IV. TOWARD A NEW AGE

If there is to be an end to corporate history, it is not the one that Hansmann and Kraakman reported or predicted. To paraphrase Winston Churchill, the first decade of the twenty-first century is not the end of corporate history, but it might well be the end of one phase of corporate history and the beginning of another.[44] Although we have entered the

(0.326), Belgium (0.246), Italy ( 0.306), Portugal (0.348), Greece (0.320), the Netherlands (0.311), Norway (0.247), Canada (0.310), Switzerland (0.324), the UK (0.354), and Australia (0.354), to name a few. Branko Milanovic & Shlomo Yitzhaki, *Decomposing World Income Distribution: Does the World Have a Middle Class?*, 48 REV. INCOME & WEALTH 155, 170 (2002). Also, between 1979 and 1989, the top 1% doubled its wealth from 22% to 39% of the overall wealth and captured 70% of all earnings growth since the mid-1970s. KEVIN PHILLIPS, WEALTH AND DEMOCRACY: A POLITICAL HISTORY OF THE AMERICAN RICH, at xiii (2002).

43. AM. FED'N OF ST. COUNTY & MUN. EMPLOYEES ET AL., ENABLERS OF EXCESS: MUTUAL FUNDS AND THE OVERPAID AMERICAN CEO 6 (Mar. 2006), http://www.aflcio.org/corporatewatch/capital/upload/enablersofexcess.pdf.

44. Winston S. Churchill, Prime Minister of the United Kingdom, Speech at the Lord Mayor's Day Luncheon at the Mansion House (Nov. 9, 1942), http://www.winstonchurchill.org/learn/speeches/speeches-of-winston-churchill/1941-1945-war-leader/987-the-end-of-the-beginning ("[T]his is not the end. It is not even the beginning of the end. But it is, perhaps, the end of the beginning."). For a sampling of the theorists who reject "shareholder primacy," see PROGRESSIVE CORPORATE LAW (Lawrence E. Mitchell ed., 1995); Gregory Scott Crespi, *Rethinking Corporate Fiduciary Duties: The Inefficiency of the Shareholder Primacy Norm*, 55 SMU L. REV. 141 (2002);

third millennium, society's most important and influential institution remains decidedly Victorian, if not occasionally feudal, in its orientation and organization. A small, unrepresentative elite of controlling shareholders, directors, and management effect a command-and-control regimen over the lives and fates of countless people. Yet, there are now some encouraging indications that there is a nascent shift in public opinion and forbearance. Not only are people beginning to lose patience with corporations, but there are also some emerging efforts to rein in their power. It is important to seize this moment of institutional disaffection and turn it to greater democratic and transformative effect. If a crisis exists, it is as much one of political will as it is of normative decrepitude. As the Italian philosopher Antonio Gramsci put it, "The crisis consists precisely in the fact that the old is dying and the new cannot be born; in this interregnum a great variety of morbid symptoms appear."[45] Indeed, the past few years have witnessed "a great variety of morbid symptoms" in regard to corporate governance.

The Enron saga, and particularly the institutional response to it, are probably most illustrative of this pathological condition. Indeed, the beleaguered company's accounting scandals and the legislative response by way of the Sarbanes-Oxley Act of 2002 (SOX) are both decidedly derivative of and trapped within the paradigm of shareholder primacy; they present an indictment of the whole conceptual basis for corporate governance. As a reasonably stern response to shaken investor confidence in financial performance, SOX contains a series of measures intended to enhance corporate responsibility, improve financial disclosure, and combat corporate and accounting fraud. To ensure more reliable processes of control, disclosure, and auditing of financial results, rules are directed to improving the efficiency of audit committees, the independence of outside auditors, the implementation of internal procedures, and the like. In particular, senior executives of large publicly traded corporations are required to validate the legitimacy of their performance reports by signing off on them. Most of these measures are mandatory in nature and impose monetary and criminal penalties for violations, although the provisions about adopting a code of ethics for the CEO and senior financial officers only require that corporations disclose whether or not they have

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Ronald M. Green, *Shareholders as Stakeholders: Changing Metaphors of Corporate Governance*, 50 WASH. & LEE L. REV. 1409 (1993); Lyman Johnson, *The Delaware Judiciary and the Meaning of Corporate Life and Corporate Law*, 68 TEX. L. REV. 865 (1990); Wai Shun Wilson Leung, *The Inadequacy of Shareholder Primacy: A Proposed Corporate Regime that Recognizes Non-Shareholder Interests*, 30 COLUM. J.L. & SOC. PROBS. 587 (1997); and David Millon, *Theories of the Corporation*, 1990 DUKE L.J. 201.

45. ANTONIO GRAMSCI, SELECTIONS FROM THE PRISON NOTEBOOKS OF ANTONIO GRAMSCI 276 (Quintin Hoare & Gregory Nowell Smith eds. & trans., 1971).

such codes and, if not, why not. From within the shareholder-centered traditional paradigm, SOX is a relatively robust initiative and, as long as it is rigorously enforced, will have some important and beneficial effects.

But while the legislative reforms might or might not improve auditing and budgetary controls, there was a singular failure on the part of regulators to appreciate that it was the single-minded focus on maximizing shareholder value that was at the heart of the problem. SOX is premised on the idea that the whole Enron debacle was attributable to management's conflicts of interest, which resulted from a lack of supervision by the board of directors.[46] Consequently, the remedy was to be found in ensuring that executive behavior was brought back into line with and disciplined by greater solicitude for the interests of shareholders through a more independent board of directors and external auditors. But ample evidence exists that the corporation's demise was fueled by the single-minded and irresponsible efforts by the management and board to inflate and maintain share prices and stock values. A continuing attachment to shareholder primacy was as much the problem as the solution.[47] Until that underlying commitment is confronted and met, there will be little progress in moving forward and avoiding further Enron-like debacles. While it might be going too far to suggest that traditional models of corporate governance are priming large corporations to become accidents waiting to happen, it is entirely appropriate to recommend that there will be little progress in combating Enron-like failures until there is a shift away from the shareholder primacy ideology that continues to dominate the theory and practice of corporate governance.

Accordingly, after a run of over 150 years, the basic model for corporate regulation is in need of serious revision. The maladies that afflict corporate governance are no longer capable of being fixed by strong doses of reformist medicine. The time has come to effect a complete rethinking of our fundamental theories about and expectations of corporations in modern Western industrialized society. As in mid-nineteenth-century England, it is now imperative to bring about a massive transformation in the structure, organization, and outlook of large corporations. Up to the

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46. Berle and Means's *The Modern Corporation* made no real distinction between board and management and, therefore, paid little attention to the power struggle within management to control the firm. *See* BERLE & MEANS, *supra* note 2, at 196. Nor did they pay much attention to the existence and impact of interlocking directorships and integrated corporate networks. As the scandals at Enron and other companies show, the board's ability and appetite to monitor management is suspect at best. For a recent comparative analysis of corporate networks, see PAUL WINDOLF, CORPORATE NETWORKS IN EUROPE AND THE UNITED STATES (2002).

47. *See* Simon Deakin & Suzanne Konzelmann, *Learning From Enron*, 12 CORP. GOVERNANCE: AN INT'L REV. 134, 141 (2004). For a very different take on SOX, see Romano, *supra* note 14.

1860s, there was the First Age of corporations in which they began life as state-sponsored enterprises to support the schemes and ambitions of fledgling nation-states in commerce and colonization. Between the 1860s and today, there has been the Second Age of corporations as private-controlled agencies for wealth accumulation and technological innovation. Giving birth to robber barons, corporate raiders, and dotcom billionaires, private corporations have become more global and only a little less exploitative in their operations as the state-directed agencies of old. There is now the need and, as importantly, the possibility for the emergence of a new paradigm for the corporation. The move away from a private conception of corporate life to a more public vision of corporations need not be a misconceived return to the pre-1860 understanding of corporations as delegated centers of state power. The new age of corporations must be one in which these vital organizations are treated as vibrant and democracy-enhancing vehicles for public and private benefit. Within such a newly emerging sensibility and milieu, the power and prestige of corporations can be harnessed to the realization of a more democratic society generally. Indeed, precisely because corporations are so pervasive and so potent in their impact on most people's daily lives, they offer a vital site at which to begin this paradigmatic overhaul. And the neglected subtheme of Berle and Means's *Modern Corporation* is an excellent place to begin that important endeavor.

## V. BACK TO THE FUTURE

It seems to be the fate of almost all canonical texts that they become not only more cited than read, but also affixed with one received and uncontroversial meaning. Berle and Means's classic monograph is wonderful proof of that tendency. If the great bulk of secondary literature is to be believed, *The Modern Corporation* comprises a series of secondary motifs around a primary theme—the need to bridge the gap between owners and management as much as the legal imposition of equitable duties can do so as to approximate the ideal situation of owner-managers. But that a particular text has been accepted into the legal canon does not mean that the light it casts is clear or certain. Indeed, as with texts that have received canonical status in literature or precedents as part of the doctrinal canon, the meaning and instruction of legal texts often remain much richer and more contested than appreciated or conceded; they do not speak for themselves, but their rereading is an occasion for valorized efforts at hermeneutical retrieval. For some, in law and literature, this richness and opacity are some of the qualities that recommend a text as great. In this sense, Shakespeare's *Hamlet* and the Supreme Court's

*Roe*[48] are great not only because of their profundity, but also because of their profligacy.[49] They have stood the test of time because of their richness and contestability, not in spite of them. Sadly, Berle and Means's *Modern Corporation* has suffered a more orthodox fate.

### *A. Re-vision*

Nevertheless, *The Modern Corporation* is not so easily pigeonholed and lends itself to convincing and suggestive alternative readings. Although it has been appropriated by mainstream corporate law academics to invoke the "separation of ownership and control"[50] thesis to advocate stronger shareholder rights, the text's "analysis was a gun on a rotating platform that could be pointed in more than one direction."[51] Indeed, *The Modern Corporation and Private Property* is a profoundly challenging, yet schizophrenic book. It is, in large and traditionally understood part, a nostalgic lament for a lost and traditional age of simple economic arrangements; this rendering has become the mainstream legacy of Berle and Means. But, in smaller and neglected part, it is also a romantic yearning for a new and revolutionary vision of social organization. Once it is appreciated that "[s]ize alone tends to give these giant corporations a social significance not attached to the smaller units of private enterprise," it is not so large a step to conclude that "[n]ew responsibilities towards the owners, the workers, the consumers, and the State thus rest upon the shoulders of those in control."[52]

This alternative and more capacious reading comes alive when Berle and Means's concern with the rise of the corporation as organizations that have "passed far beyond the realm of private enterprise . . . [and] have become more nearly social institutions"[53] is placed front and center ahead of the ownership-and-control thesis. Indeed, in 1932, they felt able to conclude *The Modern Corporation* with a chilling appraisal of American corporate power. They opined that not only did corporations represent "a concentration of economic power which can compete on equal terms with the modern state," but also that "the modern corporation may be regarded not simply as one form of social organization but potentially (if not yet actually) as the dominant institution of

48. Roe v. Wade, 410 U.S. 113, 147 (1973).

49. *See* ALLAN C. HUTCHINSON, IT'S ALL IN THE GAME: A NON-FOUNDATIONALIST ACCOUNT OF LAW AND ADJUDICATION 86–115 (2000) (discussing how literature is celebrated more for its richness of interpretive possibilities than its capacity to generate authoritative meanings).

50. J.A.C. Hetherington, *Redefining the Task of Corporation Law*, 19 U.S.F. L. REV. 229, 233 (1985).

51. *Id.* at 235.

52. BERLE & MEANS, *supra* note 2, at 7.

53. *Id.* at 46.

the modern world . . . possibly even superseding [the state]."[54] If that day of "actually" has not yet arrived, it is perilously closer; the march of corporate power has continued apace. To appreciate fully the extent to which corporations have consolidated and increased their economic sway, it is necessary to place their operations and performance in a wider global context. When this is done, the almost unrivaled dominance of these "non-Statist collectivisms"[55] in social and political as well as economic spheres can be grasped.

If corporate sales and national GDPs are treated as interchangeable, corporations comprise about 50% of the world's 100 largest economies. Of course, American corporations dominate the global group, with 82 representatives in the top 200; Japanese firms are second, with only 41 slots.[56] So, General Motors is now bigger than Denmark; Daimler-Chrysler is bigger than Poland; Royal Dutch/Shell is bigger than Venezuela; IBM is bigger than Singapore; and Sony is bigger than Pakistan.[57] Indeed, the top 200 corporations' combined sales are bigger than the combined economies of all countries, except for the biggest 10.[58] Also, the top 200 corporations' sales are growing at a faster rate than overall global economic activity.[59] But while the sales of the top 200 corporations are the equivalent of 27.5% of world economic activity, they employ only 0.78% of the world's workforce.[60] Furthermore, although those corporations' profits grew 362.4% in the past twenty years, the number of people that they employ has increased by only 14.4%.[61] The economic clout of the top 200 corporations is particularly staggering compared to that of the poorest segment of the world's humanity: their combined sales are eighteen times the combined annual income of the 1.2 billion people, or 24% of the world's total population, living in "severe" poverty (those surviving on less than $1 per day).[62]

Once what Louis Brandeis termed the "curse of bigness" is placed in contemporary context,[63] the concerns of Berle and Means become

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54. *Id.* at 313.

55. Adolf A. Berle, Jr., *Foreword*, *in* THE CORPORATION IN MODERN SOCIETY, at xiv (Edward S. Mason ed., 1959).

56. Sarah Anderson & John Cavanagh, *Top 200: The Rise of Corporate Global Power*, INST. FOR POL'Y STUD. (Dec. 4, 2000), *available at* http://www.corpwatch.org/article.php?id=377.

57. *Id.*

58. *Id.*

59. *Id.*

60. *Id.*

61. *Id.*

62. *Id.*

63. LOUIS DEMBITZ BRANDEIS, THE CURSE OF BIGNESS: MISCELLANEOUS PAPERS OF LOUIS D. BRANDEIS (Osmond K. Fraenkel ed., 1935). For more modern analyses along these lines, see GAR ALPEROVITZ, AMERICA BEYOND CAPITALISM: RECLAIMING OUR WEALTH, OUR LIBERTY, AND OUR

even more compelling. They appreciated that, because "[t]he economic power in the hands of the few persons who control a giant corporation is a tremendous force which can harm or benefit a multitude of individuals, affect whole districts, shift the currents of trade, bring ruin to one community and prosperity to another,"[64] the people who exercised power over these burgeoning corporate empires would become the new "princes of industry"[65] and a new despotism would take hold. As such, it was essential that this enormous power "shall be subjected to the same tests of public benefit which have been applied in their turn to power otherwise located" in modern society.[66] In short, therefore, if "accountability" is seen as the primary theme of the book, its concerns and proposals for change take on a very different emphasis and orientation. The private property owners became as much a part of the problem as the solution; their powers and entitlements must be harnessed to and disciplined according to the public interest. When read in this way (and almost despite the efforts of the authors themselves), *The Modern Corporation* remains a robust and still relevant critique of corporate governance at the beginning of the twenty-first century. More importantly, it still resonates strongly as a rallying call to populist arms—for all those who are committed to making the large modern corporation a worthy and welcome participant in the all-important project for democratic empowerment.

### *B. Second Thoughts?*

In many ways, it was Berle and Means's own ambivalence about pursuing the more radical implications of their critique that hindered efforts to move away from a private property regime to a more fully public re-envisioning of the corporate role and responsibility. At the end of their celebrated monograph, they begin to build on the established fact that the modern-day shareholder has clearly "surrendered a set of definite rights for a set of indefinite expectations."[67] Indeed, they go so far as to concede that, with the entrenched separation of ownership and control, the shareholders' "relation to [their] wealth" has changed and that the corporation should be seen as a public entity and "the logic applicable to that change should itself change."[68] Yet Berle and Means refused to take the next logical step, which was not only to accept the passivity of share-

DEMOCRACY (2005); CARL BOGGS, THE END OF POLITICS: CORPORATE POWER AND THE DECLINE OF THE PUBLIC SPHERE (2000); and WILLIAM K. CARROLL, CORPORATE POWER IN A GLOBALIZING WORLD: A STUDY IN ELITE SOCIAL ORGANIZATION (2004).

64. BERLE & MEANS, *supra* note 2, at 46.

65. *Id.* at 4.

66. *Id.* at 310.

67. *Id.* at 244.

68. *Id.* at 298.

holders, but also to recognize that the very idea of the shareholder as property owner was no longer valid or applicable, and that reliance on a private property rationale for corporate governance was no longer compelling or desirable.

Even at its publication in 1932, *The Modern Corporation*'s focus on the importance of the disjuncture between ownership and control did not persuade everyone. Dissenting voices could be heard, although their force and caution have long since been ignored. In particular, E. Merrick Dodd Jr. argued that corporate directors and officers should not be viewed solely as agents of shareholders, but should also be required to act as stewards for the interests of others, even if that meant curtailing the proprietary rights of those shareholders. Indeed, Dodd went so far as to suggest that managers might go further and actually consider themselves to be "guardians of all the interests which the corporation affects and not merely servants of its absentee owners."[69] Berle took up the challenge and responded to Dodd by arguing that a broad corporate duty to serve society would not only violate shareholders' private property rights, but also be so vague as to put no meaningful constraint on managers' use of corporate assets: "Unchecked by present legal balances, a social-economic absolutism of corporate administrators, even if benevolent, might be unsafe . . . ."[70] But by the late 1950s, a chastened Berle seemed to have at least conceded considerable ground in his debate with Dodd. While he recognized that managerial discretion might be viewed as a positive attribute that could allow managers to act in the interests of society as a whole,[71] Professor Berle insisted that he did not accept that Dodd was right in any absolute or prescriptive sense: "It is one thing to agree that this is how social fact and judicial decisions turned out. It is another to admit this was the 'right' disposition; I am not convinced it was."[72]

By 1968, in their new and separate prefaces for *The Modern Corporation*, Berle and Means had begun to accept many of the limitations in the thinking that underlay the original edition. Nevertheless, they were still not fully prepared to abandon their established ways of thinking. After describing the even greater level of concentration and lack of genuine competition among American corporations, the economist Means contented himself with simply asking, "Is the concentration of power in

69. E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1157 (1932).

70. Adolf A. Berle, Jr., *For Whom Corporate Managers* Are *Trustees: A Note*, 45 HARV. L. REV. 1365, 1372 (1932).

71. *See* ADOLF A. BERLE, JR., POWER WITHOUT PROPERTY: A NEW DEVELOPMENT IN AMERICAN POLITICAL ECONOMY 107–10 (1959).

72. Berle, *supra* note 55, at xii.

the managements of the large corporations consistent with the maintenance of a democratic society?"[73] On the other hand, the law professor Berle stated that, while the nature of the property rights of shareholders has changed, there is still very much a property right at work. Although "a new classification has been superimposed on the old theory"[74] and "the 'private' and, still more, individualized, aspects [of property] will become increasingly attenuated,"[75] there has now been a break-up of "the package of rights and privileges comprising the old conception of property."[76] Nevertheless, Berle came back to the conclusion that, even though there has been a move away from treating stock as primarily a vehicle for raising capital and more "a channel for distributing income whose accumulation for capital purposes is not required,"[77] the modern corporation and "property used in production [i.e., shares] must conform to conceptions of civilization worked out through democratic processes of American constitutional government."[78] He was convinced that the era of private corporations (or, at least, the understanding of corporations as extensions of private shareholding) was no longer coherent in practice or theory.

The time has come, however, to take the obvious steps that Berle and Means illuminated but felt unable or unwilling to pursue themselves. In a compelling conclusion to *The Modern Corporation*, they floated the idea of rejecting both a strengthening of the rights of passive investors and a *realpolitik* acceptance of managerial control. Instead, they offered the possibility that, because existing corporate arrangements had "cleared the way for the claims of a group far wider than either the owners or the control [group]," the community could "demand that the modern corporation serve not [only] the owners or the control [group] but [also] all society" and that the governing principle of corporate governance should be "the paramount interests of the community."[79] Indeed, Berle and Means end with a hope that the separation between ownership and control will result not in a triumph by one faction over the other, but with the rise of a new paradigm of corporate governance: "The law of corporations . . . might well be considered as a potential constitutional law for the new economic state . . . ."[80] While they were wrong in believing that the control of corporations and the balancing of interests might be af-

73. BERLE & MEANS, *supra* note 2, at xxxviii.

74. *Id.* at xi.

75. *Id.* at xiv.

76. *Id.* at xix.

77. *Id.* at xxvii.

78. *Id.* at xxvi.

79. *Id.* at 312.

80. *Id.* at 313.

fected, as in "brought about by" "a purely neutral technocracy," they were on the right track when they expressed the hope that this might be done "on the basis of public policy rather than private cupidity."[81] The challenge, therefore, is to move from "private cupidity" to "public policy" while both retaining the best of private initiative and resisting the worst of a domineering state. This can be achieved by ushering in a new era of corporate history in which democracy is the standard and the goal of corporate governance. In such a vision, corporations might begin to function as a democratic nexus at which public and private, political and economic, individual and state, and personal freedom and civic responsibility meet. Corporations will be less an anomaly in contemporary democratic terms and more a primary site for the advancement of democratic politics.

Before proceeding to sketch this democratic alternative, two preliminary caveats are worth mentioning. As critical as I am of the narrow scope and shallow substance of the existing model of corporate governance, none of my critique should be interpreted as trashing or rejecting those legal rules and doctrines which seek to control management in the name of some larger set of interests; no other group gains when managers self-deal. But in supporting such disciplinary laws, it does not follow that the effort to discipline management should be done only on behalf of shareholders. From a more democratic perspective, profit maximization will not be eschewed entirely, but will simply no longer be the exclusive or predominant goal among many other social ambitions—shareholders will be one kind of constituency member. Moreover, in recommending a shift away from the present paradigm, I am not suggesting that the whole idea of private property should be abandoned or, as some might propose, that the means of production be put in public hands. I am as much against an overbearing state as a rampant private sphere. It is more that democracy should be used as a theory and a practice to address the economic and social conditions of people's lives as much as their civil and political entitlements. The market must be made to serve, not control people's interests. In that, Milton Friedman is right in one important regard—the effort to extend the range of institutions and interests to which corporations owe obligations is a "fundamentally subversive doctrine."[82] But while this effort might signal the end of the prevailing governance arrangements, it might also be the harbinger of a more democratic society.

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81. *Id.* at 312–13.

82. MILTON FRIEDMAN, CAPITALISM AND FREEDOM 133 (1962).

## VI. FROM CORPOCRACY TO DEMOCRACY

In seeking to nurture and develop suitable forums and settings that are more local and less hierarchical, and are more participatory and less private, large corporations recommend themselves as almost ideal locations for enabling people to become full citizens in their society. They stand squarely between the market and the government, and they exert the kind of power that needs to be opened up if there is to be any real progress in closing the democratic gap between the governors and governed. Of course, such a political enterprise will demand that several crucial relations and contexts be transformed and reworked—those between corporations and the state; those inside corporations (i.e., between shareholders, management, and workers); and those between corporations and the general public. Nevertheless, it is only if such a bold strategy to advance the democratic project is commenced that any real or meaningful change in the democratic condition generally, and in corporate governance particularly, can be expected. There are risks attached to such a commitment, but there are greater dangers to maintaining the status quo.

### *A. A Democratic Gambit*

In the quarter century since Lindblom's conclusion that "the large private corporation [does not fit] into democratic theory and vision,"[83] the situation has hardly improved. Although the power and influence of corporate activities has continued to expand and deepen, a democratically inspired agenda for corporate governance has lost much of the plot. Reform efforts remain too reactive, too piecemeal, too modest, and too trapped within the prevailing paradigm. In contrast, I want to offer, in the spirit of a reworked Berle and Means approach, an unabashedly and robust democratic proposal for corporate law and governance. By understanding corporations as neither wholly public nor wholly private institutions, the hope is to move beyond the cramped language of the public–private and harness the traditional strengths of the corporate form to the more civic agenda of democracy. By envisaging and concretizing a democratic form of corporate organization, it might become possible to cultivate the kind of hybrid institution for civic interaction, both economic and political, which will be true to the democratic ambitions of all its participants.

Despite all the recent and high-profile shenanigans of bad corporate behavior, it would be mistaken to place all the critical focus on them. If

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83. CHARLES E. LINDBLOM, POLITICS AND MARKETS: THE WORLD'S POLITICAL-ECONOMIC SYSTEMS 356 (1977).

any actual progress is to be made in confronting and improving corporate wrongdoing, it demands more than an ethical and criminal condemnation of such individual conduct. As important as that is, identifying and punishing corrupt or greedy executives whose conduct is castigated by almost everyone both outside and inside the corporate world is the easy part. What is much more difficult and necessary is to address the larger organizational structures and culture within which such roguery arises and persists. It is what presently passes as "good corporate governance" that is as much of a problem as the instances of bad corporate behavior. It might be that when corporate managers are doing their jobs best, or at least well, they are doing most harm to society. This perverse state of affairs demands urgent appraisal. It is only when large corporations are understood and analyzed in the larger setting of democracy that it will be possible to move forward. Indeed, it is only when corporations are obliged to become part of, rather than remain apart from, democratic society more broadly that progress will be made. If we want "good corporate citizens," then we must seek a sea-change in how we think about corporations, how we constitute them, how we regulate them, and what we expect of them. To ignore or marginalize such issues is to renege on the most basic of democratic ambitions.

The fact that large corporations are major players in the political, economic, and social system seems to be indisputable; they exercise enormous power over the lives of ordinary people. While any accumulation of power must be treated with suspicion and mistrust in a democracy, there is no need to consider it illegitimate by its aggregation alone. Power is not the problem in and of itself, but the basis for its exercise and legitimacy. When it comes to the pedigree and consequences of corporate power, there is a considerable burden on its operatives and apologists to offer a suitable series of justifications; corporate power seems presumptively undemocratic, if not actually anti-democratic. Because the goal of shareholder primacy has become "second nature . . . to politicians,"[84] it will be necessary to offer a pragmatic alternative to the neoliberal philosophy that has proven so effective in insulating large corporations from regulation and regeneration in the public interest. As the line between government and business has become increasingly blurred, politicians are persuaded that government's only legitimate role is to facilitate business. As one critic pointedly notes, "While the business of government seems more than ever to be business, the business of business . . . [is] increasingly becoming that of government . . . ."[85]

84. Hansmann & Kraakman, *supra* note 30, at 468.

85. NOREENA HERTZ, THE SILENT TAKEOVER: GLOBAL CAPITALISM AND THE DEATH OF DEMOCRACY 166 (2001).

Despite its many different and innovative efforts, traditional theorizing has failed to make a persuasive case for how the modern corporation can be reconciled with the rhetoric and reality of democratic governance in contemporary society. In particular, a major source of bewitchment in this process is the conceptual tendency to insist that there is an almost cast-iron distinction between public undertakings and private interests. Whereas the former are considered to be the legitimate domain for democratic participation, the latter are treated as something aside from that. In this formalized approach, emphasis is placed on the source and pedigree of power rather than its effects and consequences. In a world of enormous corporate power and influence, such a disciplinary device is almost guaranteed to ignore and even condone extensive abuses of power. It guts the whole emancipatory dynamic of accountability and makes democracy safe for the private exercise of corporate power. In short, large corporations are the favored offspring of neoliberalism's attachment to the public–private distinction.[86]

### *B. Beyond Public and Private*

Yet, when viewed from a thoroughly democratic perspective, the operations and decision-making of the modern corporation cannot be immune from public oversight in the public interest. It is the "abuse of power" in substantive and real terms that is the focus of attention. The formal source of power is secondary to its effects and deprivations. Reliance on a strict public–private distinction exacerbates the pernicious effects of privatized corporate power on people's lives. Of course, it does not follow that, when understood as "the dominant institution of the modern world,"[87] corporations are to be treated in the same way as other large-scale public institutions by having the full panoply of duties and responsibilities under the administrative or even constitutional law regime imposed on them by the courts. This is to misunderstand both the nuanced and pluralistic insights of democratic governance and the structural and democratic limitations of judicial review. Although it is important to appreciate large corporations as remote and bureaucratic institutions and to emulate the participatory ambitions of modern administrative law, it is both unwise and impractical to aggregate even further power in the courts; their own democratic legitimacy is sufficiently fragile and contested to caution against an extension of judicial review's exist-

86. *See* Morton J. Horwitz, *The History of the Public/Private Distinction*, 130 U. PA. L. REV. 1423, 1428 (1982).

87. BERLE & MEANS, *supra* note 2, at 313.

ing reach.[88] Instead, a different and more substantive set of measures must be introduced that can grapple more directly and effectively with the substantive and formal dimensions of what counts as good corporate governance. If corporations can be made to function as a democratic nexus at which public and private, political and economic, individual and state, and personal freedom and civic responsibility meet, they will become less an anomaly in contemporary democratic terms and more a primary site for the advancement of democratic politics.

At the heart of a democratic compact will be a reinvigoration of the neglected fact that the corporate form is a distinctly public institution that is brought into existence by the state and has certain conditional powers delegated to it by the state. As constructions and emanations of the state, modern corporations have a distinctly public origin and a decidedly public purpose.[89] The debate about corporate governance is, therefore, about the nature and parameters of those public purposes. Once corporations are understood in this way, it no longer continues to be a question of whether it is appropriate or reasonable to ask corporate owners and administrators to pursue the public interest at all. Instead, the more telling issue is what public interests should the corporation pursue and how it should go about formulating and operationalizing them. The advancement of private interests will remain important, but will not exhaust the public interest. By availing themselves of the advantages of incorporation, investors and entrepreneurs are entering into a bargain with the state and the community—in return for the benefits of pursuing their private ambitions through the corporate form, people must accept the public responsibilities and costs that come with it. Shareholders and stakeholders would become simply different kinds of members who would include owners, directors, managers, workers, customers, suppliers, lenders, neighbors, community, etc.

## VII. A DEMOCRATIC AGENDA

There will be nothing easy about determining for the purposes of corporate governance which groups are to classify as members, by what means their interests are to be ascertained, how to ensure that those interests are adequately represented, and on what basis those often competing interests are to be weighed and balanced. But a commitment to democra-

88. *See, e.g.*, CHRISTOPHER F. EDLEY, JR., ADMINISTRATIVE LAW: RETHINKING JUDICIAL CONTROL OF BUREAUCRACY 18–19 (1990).

89. John Dewey, *The Historic Background of Corporate Legal Personality*, 35 YALE L.J. 655, 669 (1926).

cy demands that such efforts be made.[90] While a variety of strategies lend themselves to this emancipatory project, I will concentrate on four particular initiatives—limits on limited liability; a broadening of directors' fiduciary duties; the increased representativeness of the board; and the enactment of substantive regulatory standards. While each of these innovations are not novel in themselves, they will, when taken together as a package, help to bring about a genuine and thoroughgoing change in the democratic thrust of corporate governance.

### *A. Limited Liability*

Although the limited liability of corporations is considered one of the main attractions of incorporation, as it encourages investment at less risk and with greater diversification, it has some severe shortcomings. Specifically, it tends to reallocate risk rather than reduce it; it places this reallocated risk on those stakeholders (e.g., employees, neighbors, etc.) often less able to shoulder it; and it can encourage riskier behavior as corporations are excused from internalizing the full costs of their risk-taking.[91] To make democratic sense of this debate, however, it is necessary to keep a broader and more encompassing view of corporate activity. After all, as I have been at pains to emphasize, the whole notion of "governance" implies much more than simply doing profitable business; it suggests a public and accountable aspect to the dealings of the corporation that encompasses, but is not only reducible to, private gain and economic profitability. When understood from a democratic perspective, it is the limits of limited liability rather than limited liability itself that must be reconfigured.

Under such a democratic conception of corporate governance, it seems entirely unconvincing to establish an institutional framework for legal liability that shifts almost all the costs onto some persons and all the benefits onto others. At the moment, on the one hand, there is management/shareholder control without responsibility and, on the other hand, there is stakeholder responsibility without control. This is anathema to the democrat who is committed to closing, not maintaining, the gap between the powerful and the less powerful. If people claim the rights of ownership and the authority to govern the corporation in their

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90. I have begun the effort to flesh out practical strategies to meet these challenges in a Canadian context. *See* ALLAN C. HUTCHINSON, THE COMPANIES WE KEEP: CORPORATE GOVERNANCE FOR A DEMOCRATIC SOCIETY (2006).

91. *Compare* EASTERBROOK & FISCHEL, *supra* note 35, at 40–61 (arguing that with limited liability, shareholders risk only the loss of their investments in the event of corporate misconduct), *with* Green, *supra* note 44, at 1415 (arguing that limited liability represents a "social subsidy" against corporate misconduct that can yield potentially massive benefits to shareholders).

own best interests, it seems almost axiomatic that they should at least bear some responsibility for its actions and behavior. That said, if the shareholders' lack of responsibility is to continue to any extent, then there seems no compelling reason to object to the reduced control of shareholders or their displaced focus as the corporation's main concern. From a democratic perspective, the price of limited liability is the cost of reduced influence. While there are also other legal mechanisms by which to reduce negative externalities created by corporate conduct (i.e., general welfare laws designed to deter corporate conduct through criminal and civil sanctions), the imposition of some liability in some circumstances on shareholders seems democratically optimal.[92]

Rather than take an all-or-nothing stance, it is better to provide a series of initiatives that can be combined to affect the limited and selective availability of limited liability. Possible legal strategies for limiting limited liability include narrowing its scope to contractual risk as opposed to tort liability, introducing *pro rata* liability for shareholders,[93] lifting the corporate veil more, imposing selective liability on controlling shareholders, abolishing limited liability for shareholding corporations, and greater vicarious liability of directors in certain circumstances.[94] Each has the distinct potential to affect a more acceptable balance of control and risk; traces of each approach can already be detected in corporate law. But, when understood as part of an integrated and democratic approach to corporate governance, they can work together to provide a more subtle, balanced, and measured solution.

### *B. Extended Duties*

The next step in transforming the modern corporation into a more democratic and more public-oriented institution is to take seriously the assertion that the board of directors must exercise their powers and fulfill their fiduciary duties "in the best interests of the corporation." In defining which interests best comprise the corporation, it will be necessary to take a more expansive view than the limited focus on the interests of one

92. The available historical and empirical evidence strongly suggests that there would be little effect on the operation and innovativeness of capital markets if there was a reduction in limited liability. *See* PHILLIP I. BLUMBERG, THE MULTINATIONAL CHALLENGE TO CORPORATION LAW: THE SEARCH FOR A NEW CORPORATE PERSONALITY 121–50 (1993); Peter Z. Grossman, *The Market for Shares of Companies with Unlimited Liability: The Case of American Express*, 24 J. LEGAL STUD. 63, 63 (1995).

93. *See* Theresa A. Gabaldon, *The Lemonade Stand: Feminist and Other Reflections on the Limited Liability of Corporate Shareholders*, 45 VAND. L. REV. 1387, 1447 (1992); Henry Hansmann & Reiner Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 YALE L.J. 1879, 1880 (1991).

94. *See* Timothy P. Glynn, *Beyond 'Unlimiting' Shareholder Liability: Vicarious Tort Liability for Corporate Officers*, 57 VAND. L. REV. 329 (2004).

set of stakeholders, namely the shareholders. Such interests are entirely deserving of consideration, but they will be only one set of interests to be taken into the balance and not the exclusive or primary ones. The ghost of *Dodge* must be exorcized once and for all.[95] The corporation is an organic entity with multiple and shifting constituents whose interests will vary over time and in different contexts; no one set of interests will have its thumb on the governance scales. In advancing the welfare of the corporation, it will be important to assess the directors' performance over an extended time frame rather than on a single-decision basis; the best interests of the corporation will not be reducible to a simple formula or set of fixed interests. This will be a challenging undertaking for directors and one that will demand a variety of skills and sensitivities. Traditional critics will be right to point out that such general obligations will not easily be rendered operational, instilled with specific substance, or given effective teeth; this broad responsibility can become a shield to justify any action by the board. As Berle himself observed, "[U]nchecked by present legal balances, a social-economic absolutism of corporate administrators, even if benevolent, might be unsafe."[96] These are reasonable objections but insufficiently compelling to derail the whole project.

As things presently stand, the directors must often balance the competing interests of different shareholders in a constantly shifting market—are long-, medium-, or short-term interests of the shareholders to be served? Are directors to concentrate on increasing production and dividends or managing the share price? How is equity to be ensured among majority and minority interests? These are far from easy questions and require considerable sophisticated judgment by the directors. Of course, extending the directors' fiduciary duty to stakeholders will not lessen that challenge. But it also will not move it into a qualitatively different realm of operational difficulty. There are already several fiduciary relationships imposed by law (e.g., executors) that encompass duties to a class of persons or groups whose interests might well be far from unitary or readily compatible. Consequently, while demanding and difficult, the application of a broader fiduciary duty is certainly not outside the competence of sophisticated businesspersons. Rather than be an exceptional duty, the fiduciary responsibility of directors would be brought in line with the thematic principle that fiduciaries are to be held "to something stricter than the morals of the marketplace. . . . Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by

95. Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1919).

96. Berle, *supra* note 70, at 1372; *see also* 3 FRIEDRICH A. HAYEK, LAW, LEGISLATION AND LIBERTY: THE POLITICAL ORDER OF A FREE PEOPLE 82 (1979).

the crowd."[97] In the campaign to democratize the corporation, this seems an essential and welcome reform.

### *C. Representative Boards*

Corporate duties to stakeholders are an improvement, but they are not a lasting or substantial solution, and their effects will be muted. Unless there is a change in the composition of those entrusted with the power and responsibility to run the corporation, it will always be what managers or shareholder-appointed directors think is in the best interests of the broader stakeholder community rather than stakeholders being able to determine that for themselves. After all, democracy is not only supposed to be *for* the people, but *of* the people. No matter how benign or progressive the decisions made by elite groups may be, they remain decisions that lack the important imprimatur of democratic participation: accountability is only a poor second to participation as a mode of democratic governance. As with other institutions and agencies charged with advancing the public interest, there is a compelling need for public participation. Accordingly, as well as reforming the rules for proxy voting, strenuous efforts must be made to introduce reforms that will facilitate involvement by those stakeholder groups whose interests are directly and substantially at stake in corporate behavior.

Because the potential effects of large-scale corporate activities are truly wide-ranging and often global, however, this challenge is beset by practical difficulties. The two main initiatives to date for dealing with this conundrum are "diversified shareholding" and "independent directors." While they both make important inroads into present arrangements, they fall short of any truly democratic goal. Whereas independent directors are themselves appointed by and are often beholden to the existing shareholder-appointed board, diversified shareholding tends to reinforce the existing scheme of corporate governance by perpetuating the idea that financial contribution is the best measure of democratic participation.[98] When employees become shareholders, the real threat is that they become persuaded to adopt the same purely economic mentality to corporate planning and success as today's shareholders; they will be more interested in short-term gains in the secondary stock market than in long-term contributions to the primary goods-and-services and jobs markets.

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97. Meinhard v. Salmon, 164 N.E. 545 (N.Y. 1928).

98. Also, apart from the dangers of cooptation, employees might actually become more vulnerable because, if the corporation gets into serious problems, they will stand to lose not only their jobs but also their savings. *See* KIM MOODY, WORKERS IN A LEAN WORLD: UNIONS IN THE INTERNATIONAL ECONOMY 93–108 (1997).

A more convincing avenue of democratic reform would be to introduce independence and diversification in a more direct manner. For instance, it might be possible to divide affected persons and stakeholders into three main constituencies. Each constituency would represent and give increased involvement to different members of the corporate community. The three constituencies would be the shareholders, the employees, and the other stakeholders or the public. As regards the shareholder constituency, all shareholders might have the same entitlements and responsibilities with no one shareholder being able to exercise more than 25% of the overall total of votes available to shareholders. When it came to the employees, all existing and permanent employees, part-time and full-time as well as management and rank-and-file, would be eligible to vote for a third of the board; those who stood for election as employee-representatives would themselves have to be employees. Finally, as regards the public constituency (which would include all other stakeholders, such as creditors, suppliers, customers, local community, etc.), there might be an attempt to designate a third of the board as "general public directors" whose mandate would be to represent the public interest as it applies to the operations of a particular corporation. These directors could be selected by a two-thirds vote of the rest of the already-elected board of shareholder and employee representatives from a list of approved candidates maintained by a public agency. The agency would have ultimate authority to approve or disapprove such elected persons as being suitably diverse and pertinent to the specific corporation's operations.[99] To be admitted to this list, candidates would have to satisfy the regulatory body that they not only had general directorial competence, but that they also appreciated the public role and democratic responsibilities of corporations.

By establishing such a balanced scheme of membership, certain important advantages will accrue. Apart from the general conformity of the proposal to a democratic vision of corporate governance, the most obvious benefits are twofold. First, even if individual directors take a very self-regarding stance by pushing only for the interests of those groups who elected them, they will still have to persuade others of the more general wisdom of that stance. It will likely require a more long-term approach to directorial debate so that priorities and plans will be able to proceed on a more consensual basis. Also, being exposed to different perspectives might well loosen the more parochial concerns of

99. This proposal for "public interest directors" draws on a neglected and before-its-time idea by Christopher Stone. *See* CHRISTOPHER D. STONE, WHERE THE LAW ENDS: THE SOCIAL CONTROL OF CORPORATE BEHAVIOR 152–83 (1975) (proposing general and specific public directorships that would be responsible to the public).

particular directors. Moreover, the active presence of the public directors will oblige other directors to develop and frame their views in ways that are more conducive to the promotion of the general public interest. Second, because the board of directors would be under a broad fiduciary duty to advance the interests of the whole corporation, the considerable challenge of balancing competing interests and objectives might be more easily accomplished. By having a more diverse and representative board, an appreciation of what is in the best interests of the corporation *as a whole* will be more informed and immediate: the various stakeholder communities will have a direct voice in discussions. This will also help to destabilize the ruling elite, which presently has a virtual lock on corporate decision-making and culture. Accordingly, the odds on making the democratic wager are significantly shortened by the appointment of a more diverse and representative board of directors.[100]

### *D. Substantive Measures*

Nevertheless, while such reforms in representation will be extremely important, they again will be insufficient in themselves to implement a democratic system of corporate governance. The introduction of more stakeholder-representative boards, greater responsibility for corporate actors and beneficiaries, and better protections for minority shareholders will be vitally important. But they will not be enough. If the goal is to ensure that large corporations act in a more democratic and responsive manner, it will also be essential to lay down certain minimum substantive standards against which corporate performance and behavior can be judged. Accordingly, there will need to be a mix-and-match balance between structural reform and substantive regulation. As traditional scholars insist, it is naive to believe that asking present corporate officers to act responsibly for the benefit of stakeholder communities will be sufficient or that making structural changes without some accompanying ethical shift will achieve a marked degree of democratic modification.[101] In

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100. The proposal that various stakeholders might have a voice or play a part in the governance of a firm is far from novel or radical. In Germany (and Japan), for example, it is mandated by the *Mitbestimmung* (workers co-determination) law that there is to be worker representation on the supervisory boards of large public corporations. While the impact of this innovation should not be exaggerated, it has not brought German capitalism to its knees. Indeed, some might argue that it has been a contributing factor in the relative success of German industry. *See* Peter Cornelius & Bruce Kogut, *Creating the Responsible Firm: In Search for A New Corporate Governance Paradigm*, 4 GER. L.J. 45, 47 (2003). Moreover, the fact that such arrangements are now being dismantled does not speak to their democratic desirability or efficacy; it does speak to the globalizing pressure of a shareholder-centric approach.

101. Whether the goal is profit maximization or something broader, substantial change will require even optimal laws to be supplemented by social and moral sanctions. *See* Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 733 (2005).

order for there to be genuine change and transformation in corporate behavior, it will be necessary for society as a whole to participate in the continuing responsibility of determining what is "in the public interest." As public institutions, and government-created ones at that, corporations must at a minimum be obliged to ensure that they do not act in a way that is inimical to the public interest. As things presently stand, the public interest is too often a by-product of what happens to advance corporate and private interests at any given time and place. In a democracy, the public, through democratic institutions and processes, determines what the public interest is; the determination is not for corporations either by design or default to appropriate that task entirely for themselves.

As well as improved transparency in corporate transactions and dealings, it would also be necessary to introduce mandatory disclosure and reporting on a whole range of economic and social issues that might include, for example, information on the products a company produces and the countries in which it does business; on the corporation's law compliance structure; on its domestic labor practices; on its global labor practices and supplier/vendor standards; on its domestic and global environmental effects; on corporate charitable contributions, political contributions, or the effects of using a corporation's products on consumer health and safety.[102] But if corporate governance is to be taken seriously on its own terms, the enactment and enforcement of such regulations must not be left only to securities regulators. While the protection of shareholder interests is a necessary feature of any advanced economy, it is not and should not be the only game in town. Of course, it is not surprising that the authorities persist in treating corporate governance as largely about the protection of shareholder interests alone when the informing vision of corporate governance is so shareholder-centered in orientation, content, and enforcement. Accordingly, under a democratic model of corporate governance, it will be essential to create and empower a public regulatory body whose exclusive responsibility is to deal squarely with corporate governance in its own right and not only as a function of the protection of shareholder interests. Because the size and power of large modern corporations has assumed such significance, it is clear that they warrant their own regulatory body.

### *E. Democracy and Capitalism*

Finally, in offering this robust critique of contemporary approaches to corporate law and governance, it bears emphasizing that my intention

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102. *See* Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197 (1999).

has not been to defend the claim that productivity or profit-making is a bad thing. Nor am I recommending that all jobs will be forever safe or that the workers' and other stakeholders' interests will always outweigh those of shareholders. This would be plain silly. There is nothing wrong with productivity, efficiency, profitability, etc. Indeed, they are essential values for any modern society to embrace and foster. But it is the elevation of such values to a cluster of meta-values against which all social processes and other values must be judged that is the problem. As both a matter of historical record and as an issue of public policy, it is mistaken to suggest shareholder value maximization is or ought to be the sole or primary goal of the business corporation. This would be, as an incredulous critic notes, "to define the business corporation . . . as a kind of shark that lives off the community rather than as an important agency in the construction, maintenance, and transformation of our shared lives."[103] In particular, there is no sense in thinking about large corporations as a democratic venue for democratic engagement between political equals. While a cost-benefit analysis is necessary and desirable, it ought to be the first step in making any corporate decision, not the first, last, and only consideration. The process of formulating benefits and entitlements is important in itself under a democratic theory; an appreciation of the social context within which individuals exist and thrive is essential.

There is simply no reason to be persuaded that capitalism and democracy are somehow synonymous.[104] Indeed, the link between capitalism and democracy is weak at best and counterproductive at worst. If capitalism is to remain, then it must serve rather than master the interests of democracy. Citizens are entitled to basic economic protections by virtue of their membership in society and not only through their efforts at contractual negotiations. Democrats appreciate that, while everything has a cost, it is not the sole measure of value: citizens are not only consumers. And democracy is not only or best sold in the marketplace. Indeed, as Amy Chua has noted, "Markets concentrate wealth, often spectacular wealth, in the hands of the market-dominant minority, while democracy increases the political power of the impoverished majority."[105] The obvious challenge is to ensure that politics is played out throughout social

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103. James Boyd White, *How Should We Talk About Corporations? The Languages of Economics and of Citizenship*, 94 YALE L.J. 1416, 1418 (1985); *see also* LAWRENCE E. MITCHELL, CORPORATE IRRESPONSIBILITY: AMERICA'S NEWEST EXPORT (2001).

104. For a sophisticated attempt to portray "market economics" as an (American) article of faith, see ROBERT H. NELSON, ECONOMICS AS RELIGION: FROM SAMUELSON TO CHICAGO AND BEYOND (2001); *see also* JOHN KAY, THE TRUTH ABOUT MARKETS: THEIR GENIUS, THEIR LIMITS, THEIR FOLLIES (2003); GEORGE SOROS, OPEN SOCIETY: REFORMING GLOBAL CAPITALISM (2000).

105. AMY CHUA, WORLD ON FIRE: HOW EXPORTING FREE MARKET DEMOCRACY BREEDS ETHNIC HATRED AND GLOBAL INSTABILITY 6 (2003).

life and not merely confined to areas outside the economic sphere; people are entitled to participation and accountability in their dealings with and inside businesses as much as with politicians and governments. Accordingly, a shift to more democratically structured corporations will likely galvanize the democratic instinct generally. As President Woodrow Wilson famously opined, "[T]he cure for the ills of democracy is more democracy, not less."

## VIII. CONCLUSION

Recent events in corporate governance have at least opened up a space to think seriously about how it might be possible to turn the present system's failings to transformative effect. Indeed, with effort and imagination, it might presently be possible to bring to an end the age of the corporation as a private-controlled agency for wealth accumulation. Uncoupled from "market capitalism" and hitched to a more democratic vision, the institution of the corporation can become a social, political, and economic organization in which public, political, and distributive ends are in play as well as private, economic, and productive ones. Berle and Means's *The Modern Corporation* has a definite contribution to make to that project provided that its traditional reading is abandoned and its more enlightened alternative theme is emphasized: A shift must occur from "private property" to "democratic accountability" such that public policy is not only consistent with private cupidity. When large corporations are understood and analyzed in the larger setting of democracy, it will be possible to move forward. By carrying out such a democratic stock-taking, it might then be possible to provide a more telling critique of corporate governance and to offer more constructive proposals for change. Indeed, it is only when corporations are obliged to become part of, rather than remain apart from, democratic society more broadly that progress will be made.

But the present conditions of decay and deterioration will only last for a short time. Any window of opportunity is already closing fast: the old habits and entrenched arrangements are beginning to reassert themselves. In the meantime, it is essential that those who take the democratic imperative seriously act quickly and decisively; the opportunity might not come again or soon. A belated seventy-fifth anniversary of Adolf A. Berle and Gardiner C. Means's *The Modern Corporation and Private Property* could be celebrated in no more fitting or timely way than with such an initiative. Indeed, it might well be that, as goes corporate governance, so goes democracy.